

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of :  
Federal Insurance Company :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
of a Determination or a Refund of Corporation Tax :  
under Article 33 of the Tax Law for the Years 1977 :  
& 1978. :

State of New York  
County of Albany

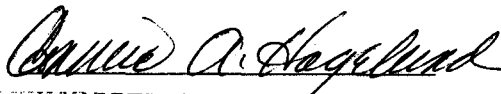
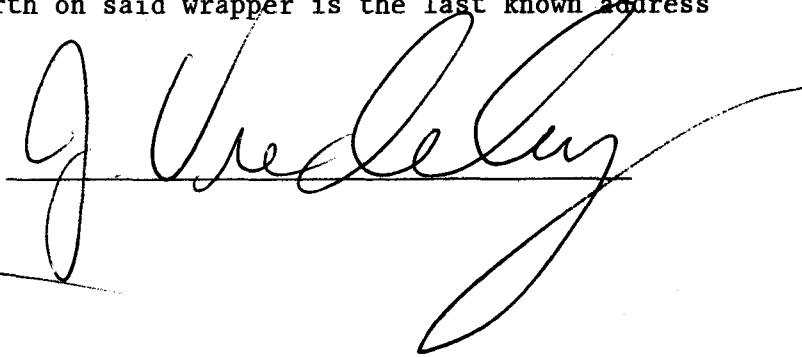
Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 9th day of November, 1982, he served the within notice of Decision by certified mail upon Federal Insurance Company, the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

Federal Insurance Company  
51 John F. Kennedy Pkwy.  
Short Hills, NJ 07078

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the petitioner herein and that the address set forth on said wrapper is the last known address of the petitioner.

Sworn to before me this  
9th day of November, 1982.



AUTHORIZED TO ADMINISTER  
OATHS PURSUANT TO TAX LAW  
SECTION 174

STATE OF NEW YORK

STATE TAX COMMISSION

In the Matter of the Petition :  
of :  
Federal Insurance Company :

AFFIDAVIT OF MAILING

for Redetermination of a Deficiency or a Revision :  
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State of New York  
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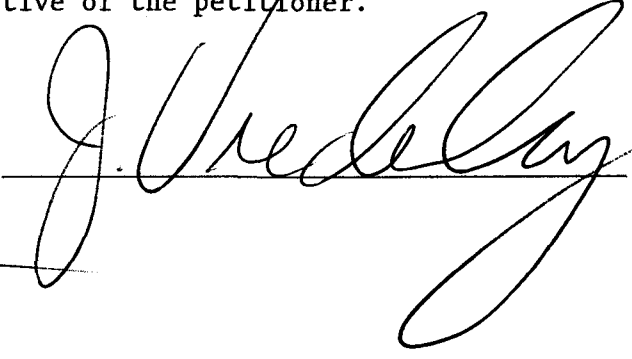
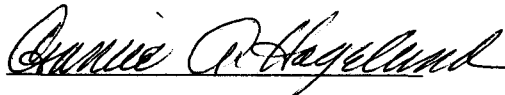
Jay Vredenburg, being duly sworn, deposes and says that he is an employee of the Department of Taxation and Finance, over 18 years of age, and that on the 9th day of November, 1982, he served the within notice of Decision by certified mail upon John S. Breckinridge the representative of the petitioner in the within proceeding, by enclosing a true copy thereof in a securely sealed postpaid wrapper addressed as follows:

John S. Breckinridge  
Everett, Johnson & Breckinridge  
20 Exchange Place  
New York, NY 10005

and by depositing same enclosed in a postpaid properly addressed wrapper in a (post office or official depository) under the exclusive care and custody of the United States Postal Service within the State of New York.

That deponent further says that the said addressee is the representative of the petitioner herein and that the address set forth on said wrapper is the last known address of the representative of the petitioner.

Sworn to before me this  
9th day of November, 1982.

ADMINISTERED TO ADMINISTER  
OATHS PURSUANT TO TAX LAW  
SECTION 174

STATE OF NEW YORK  
STATE TAX COMMISSION  
ALBANY, NEW YORK 12227

November 9, 1982

Federal Insurance Company  
51 John F. Kennedy Pkwy.  
Short Hills, NJ 07078

Gentlemen:

Please take notice of the Decision of the State Tax Commission enclosed herewith.

You have now exhausted your right of review at the administrative level. Pursuant to section(s) 1503 of the Tax Law, any proceeding in court to review an adverse decision by the State Tax Commission can only be instituted under Article 78 of the Civil Practice Laws and Rules, and must be commenced in the Supreme Court of the State of New York, Albany County, within 4 months from the date of this notice.

Inquiries concerning the computation of tax due or refund allowed in accordance with this decision may be addressed to:

NYS Dept. Taxation and Finance  
Law Bureau - Litigation Unit  
Albany, New York 12227  
Phone # (518) 457-2070

Very truly yours,

STATE TAX COMMISSION

cc: Petitioner's Representative  
John S. Breckinridge  
Everett, Johnson & Breckinridge  
20 Exchange Place  
New York, NY 10005  
Taxing Bureau's Representative

STATE OF NEW YORK  
STATE TAX COMMISSION

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In the Matter of the Petition  
of  
FEDERAL INSURANCE COMPANY  
for Redetermination of a Deficiency of Franchise  
Tax on Insurance Corporations under Article 33  
of the Tax Law for the Years 1977 and 1978.

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DECISION

Petitioner, Federal Insurance Company, 51 John F. Kennedy Parkway, Short Hills, New Jersey 07078, filed a petition for redetermination of a deficiency of franchise tax on insurance corporations under Article 33 of the Tax Law for the years 1977 and 1978 (File No. 33253).

In a letter dated July 1, 1982, petitioner, by its agent and attorney, Eugene Chester, waived a formal hearing and consented to submission of this matter to the State Tax Commission. The following decision is rendered upon the file as presently constituted.

ISSUE

Whether petitioner is entitled to exclude from its "entire net income" interest received from bonds issued by the Government of Puerto Rico.

FINDINGS OF FACT

1. Petitioner, Federal Insurance Company, timely filed franchise tax returns for insurance corporations for 1977 and 1978.
2. On April 1, 1981, the Audit Division issued to petitioner notices of deficiency, asserting additional franchise taxes due under Article 33 of the Tax Law for the years 1977 and 1978 of \$127,933.81 and \$44,017.00, respectively.

3. In its Statement of Audit Adjustment dated February 18, 1981 for the period ended December 31, 1977, the Audit provided the following explanation for the 1977 deficiency:

"All interest and dividends are required to be included in New York entire net income regardless of the tax provisions under the Internal Revenue Code. Therefore, the Puerto Rico Bond Interest in the amount of \$1,624,943 must be added to federal taxable income in arriving at New York entire net income. The investment expenses in the amount of \$508,629 have been disallowed as a deduction from tax exempt income since it appears that this amount was already deducted in computing federal taxable income.

The adjustment for sale of property acquired prior to January 1, 1974 has been adjusted to a loss of (\$10,902,117). When the fair market value at December 31, 1973 is the same as the federal basis, the New York gain or loss is the same as the federal gain or loss. Therefore, the computation for Credit Foncier De France, Credit National and Washington Public Power Hanford has been adjusted on this basis. Also, IBM, Inc. has been adjusted to the difference in the net proceeds and the fair market value at December 31, 1973.

A New York capital loss carryover is limited to the amount allowed for federal tax purposes. Therefore, the loss claimed in the amount of (\$11,501,391) has been disallowed."

4. In another Statement of Audit Adjustment also dated February 18, 1981 for the period ended December 31, 1978, the Audit Division provided the following explanation for the 1978 deficiency:

"All interest and dividends are required to be included in New York entire net income regardless of the tax provisions under the Internal Revenue Code. Therefore, the Puerto Rico Bond Interest in the amount of \$1,656,675 must be added to federal taxable income in arriving at New York entire net income.

The investment expenses in the amount of \$665,596 have been disallowed as a deduction from tax exempt income since it appears that this amount was already deducted in computing federal taxable income."

5. Petitioner is an insurance corporation organized under the laws of the State of New Jersey and is engaged in the insurance business in New York State as a property and casualty insurer. It reported to New York State entire net income of \$27,480,050 and \$56,997,056 for the 1977 and 1978 tax years, respectively.

6. The petitioner, by its agent and attorney, Eugene Chester, executed a Withdrawal of Petition and Discontinuance of Case dated February 2, 1982 in which it accepted the cancellation of deficiencies of \$113,082.64 and \$12,616.00 for the 1977 and 1978 tax years, respectively, and disagreed as to deficiencies of \$14,851.17 and \$31,401.00 for the 1977 and 1978 tax years, respectively.

7. In its perfected petition, dated April 20, 1982, petitioner alleged that the inclusion in entire net income by the Audit Division of interest received from bonds issued by the Government of Puerto Rico in the amounts of \$1,624,943 and \$1,656,675 for the 1977 and 1978 tax years, respectively, was "in error as the taxation of such income (by New York State) is prohibited by federal law...". Therefore, it seeks a redetermination of deficiencies in the amount of \$14,851.17 and \$31,401.00 for the 1977 and 1978 tax years, respectively.

#### CONCLUSIONS OF LAW

A. That for taxable years commencing on or after January 1, 1974, insurance corporations are subject to two franchise taxes imposed by Article 33 of the Tax Law. Tax Law section 1501 imposes a franchise tax similar to that which is imposed on business corporations by Article 9-A. Pursuant to Tax Law section 1502, the tax is the greatest amount yielded from four alternative bases, the first being the portion of the taxpayer's entire net income allocated to New York. Tax Law section 1510 imposes an additional franchise tax, similar to that imposed by former Tax Law section 187, measured by the taxpayer's premiums.

B. That Tax Law section 1503 sets forth the manner in which entire net income is to be calculated. Tax Law section 1503(b)(2)(B) provides that entire net income shall be determined without the exclusion, deduction or credit of:

"(A)ny part of any income from dividends or interest on any kind of stock, securities or indebtedness, except as provided in Subparagraphs (A) and (B) of paragraph one hereof (income from subsidiary capital and fifty percent of dividends other than from subsidiaries)."

C. That 48 U.S.C. section 745 provides:

"All bonds issued by the Government of Puerto Rico, or by its authority, shall be exempt from taxation by the Government of the United States, or by the Government of Puerto Rico or any political or municipal subdivision thereof or by any state, territory or possession, or by any county, municipality or other municipal subdivision of any state, territory or possession of the United States, or by the District of Columbia."

D. That 31 U.S.C. section 742 provides:

"All stocks, bonds, Treasury notes and all other obligations of the United States, shall be exempt from taxation by or under State or municipal or local authority. This exemption extends to every form of taxation that would require that either the obligations or the interest thereon, or both, be considered, directly or indirectly, in the computation of the tax, except nondiscriminatory franchise or other nonproperty taxes in lieu thereof imposed on corporations and except estate taxes or inheritance taxes."

E. That interest earned on exempt federal obligations may be included in taxable net income for the computation of nondiscriminatory franchise taxes.

Northern Finance Corp. v. Tax Commission, 290 U.S. 601 (1933) and Werner Machine Co. v. Director of Division of Taxation, 350 U.S. 492 (1956).

F. That although 48 U.S.C. section 745 does not include an explicit statutory provision similar to the "exception clause" in 31 U.S.C. section 742, it does not manifest any intent "that the exemption should extend beyond a prohibition against direct taxation...". Rochester Bank and Trust Company, 305 N.W.2d 776, at 779 (Minn. Sup. Ct. 1981).

G. That Tax Law Article 33 imposes franchise taxes upon insurance corporations rather than taxes on income. These taxes are imposed upon a privilege of doing business in New York in a corporate capacity, and the tax is computed on the value of that privilege, which is measured by income (or some alternate

basis). The petitioner's income is not taxed directly. Rather, it is used to measure the value of the privilege being taxed, and it properly includes all of the income of the taxpayer.

H. That, therefore, the petition of Federal Insurance Company is hereby denied and the notice of deficiency issued April 1, 1981, as modified by Finding of Fact "6", is sustained.

DATED: Albany, New York

NOV 09 1982

STATE TAX COMMISSION

*Robert M. Banduch*  
Acting PRESIDENT

*Francis Q. Koing*  
COMMISSIONER

*W. J. Hall*  
COMMISSIONER